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Tax and Regulatory

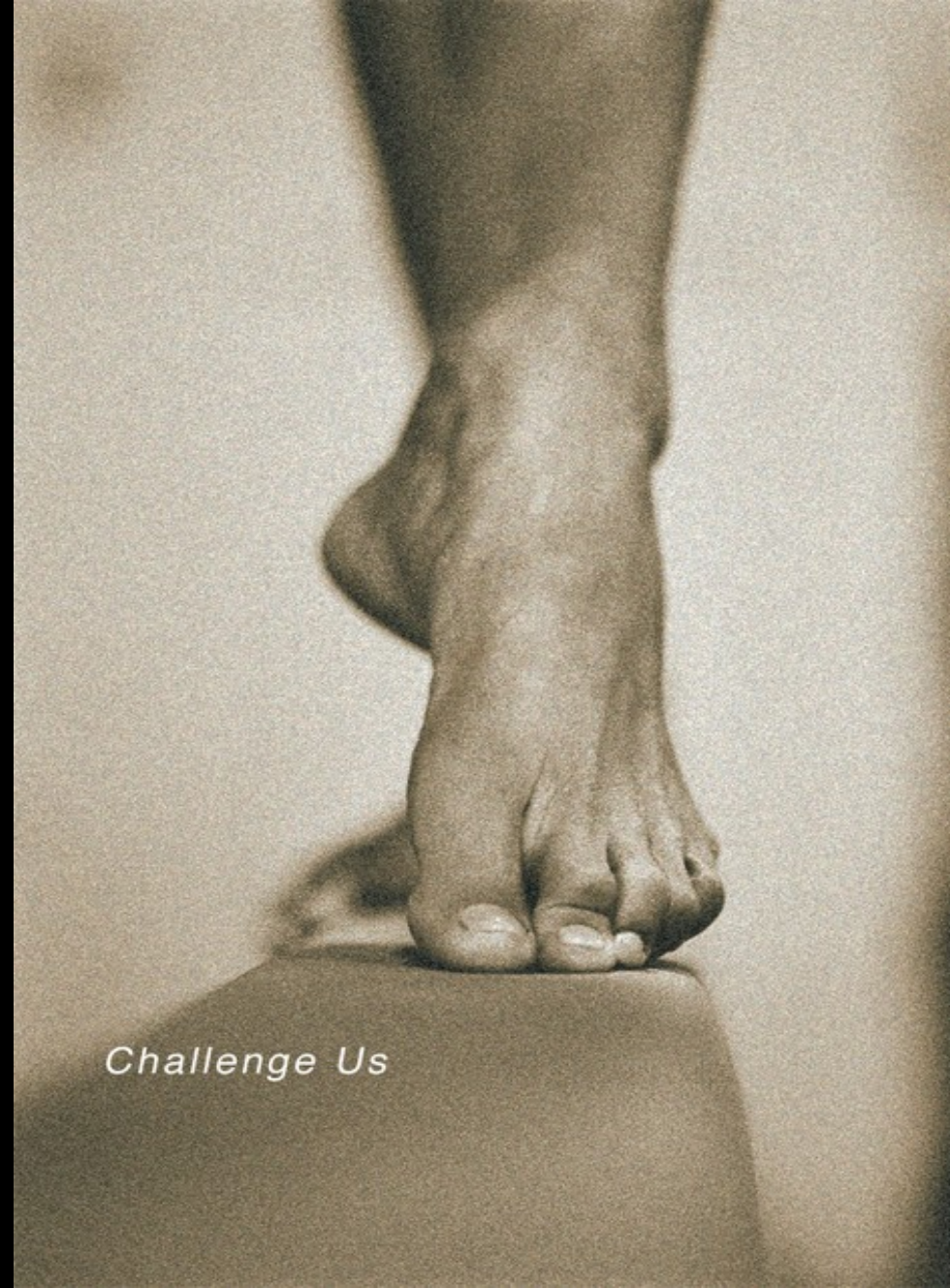
CASE STUDIES ON INVESTMENT STRUCTURING

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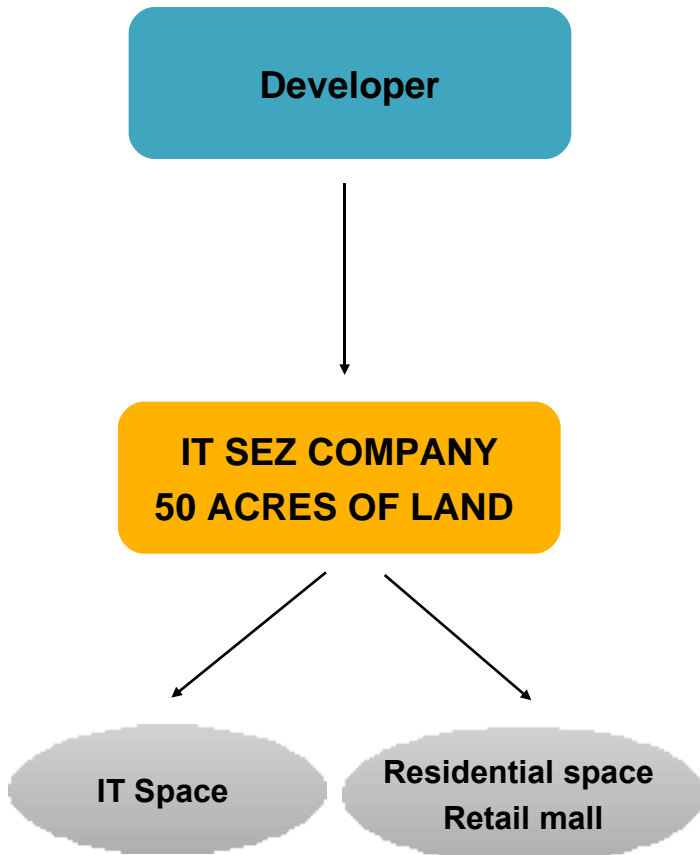


CASE STUDY # 1



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CASE STUDY # 1 – FACTS



- Developer holds certain land at historical cost in an SPV (“SPV 1”) which has been notified as an IT SEZ
- The proposed business model for development of the land includes residential and retail development – *tax break not available on income from these income streams*
- Investor company (“I Co”) proposes to invest Rs 100 crores for the project
- Developer wishes to dilute only a small stake and hence the I Co and Developer agree on a mezz structure

CASE STUDY # 1 – KEY COMMERCIAL TERMS

- I Co will commit investment of Rs 100 crores on the following terms
 - - I Co to initially start with a 50% stake in the project
 - A guaranteed return of 15% per annum (return net of tax)
 - Repayment of the agreed return (including the principal) between 3 to 5 years from the original investment
 - I Co's investment to be subordinate to third party debt
 - Post repayment of the agreed return along with the original principal, I Co's stake in the project to be diluted to 30%

- A part of the proceeds from the investment to be taken out by the Developer

CASE STUDY # 1 – KEY CHALLENGES / ISSUES

Regulatory constraints

- Change in law preventing / impacting the issue of redeemable preference shares and debentures
- Maximum cap on rate of dividend on preference shares
- Lack of clarity on interest cap on debentures
- Relatively restrictive guidelines on buy backs

Project dynamics

- Significant cash flows from residential
- Best exit from retail through sale to a strategic investor
- IT blocks dependent on external funding
- Relatively unfavorable debt equity ratio from buy back perspective

Transaction structuring - Key challenges

- Instruments to be used
- Structure for the payment of the agreed return and repayment of capital within the agreed time
- Mode and extent of security to be provided to I Co
- Tax efficiency structure for the exit from the retail mall
- Structure for the repatriation of funds to the promoter

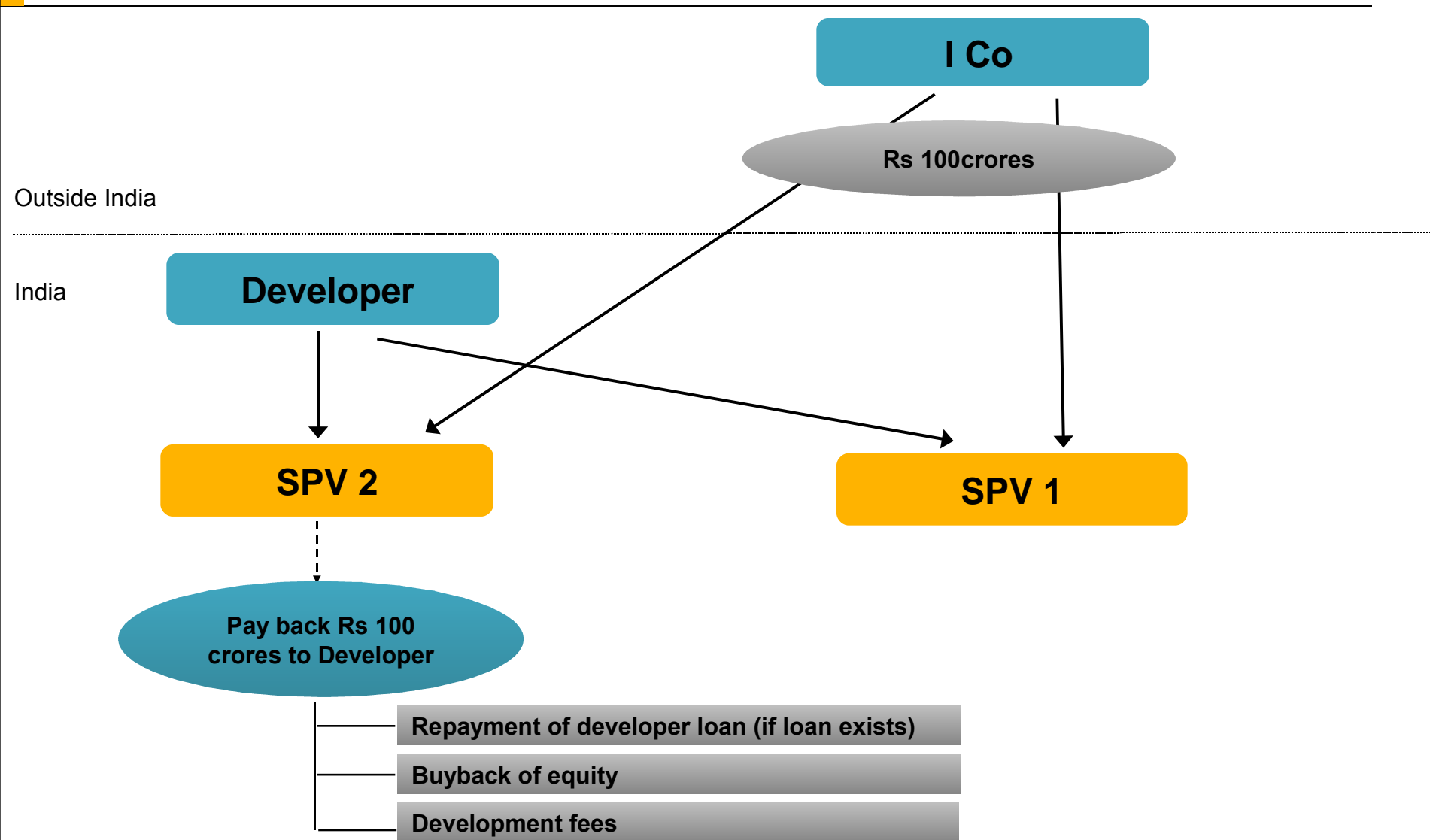
CASE STUDY # 1 – POSSIBLE OPTIONS / SOLUTIONS

**Spin-off of
non-
processing**

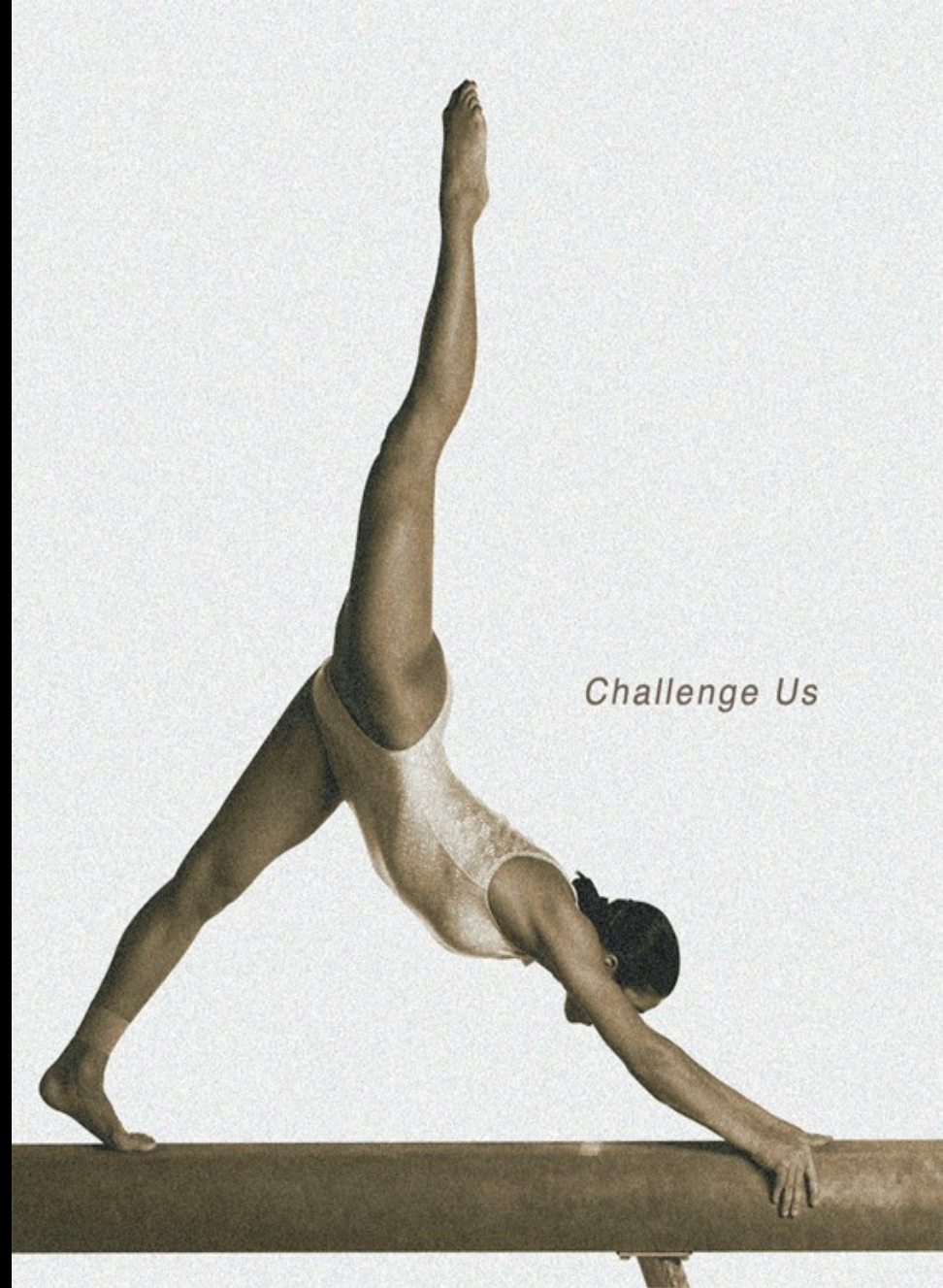
**Funding
instruments**

- Residential and retail mall development to be carried out in SPV 2 with the BoA approval
- Significant portion of the investment from I Co to be routed through this entity
- Ring-fence the cash flows from residential and retail
- Provide flexibility for exit from the mall through sale of shares of the SPV after sale of residential units
- Better financial position from a buy back perspective
- Significant investment in SPV 2 to facilitate cash extraction
- Investment into SPV 2 to be primarily in the form of convertible debentures to provide tax break to this SPV
- Nominal equity investment (resulting in 50% stake) in both the entities
- Balance investment in SPV 1 to be in the form of Class A shares resulting in repatriation through dividends
- Use of difference classes of equity shares to facilitate cash extraction

SCHEMATIC REPRESENTATION OF ONE OF THE OPTIONS

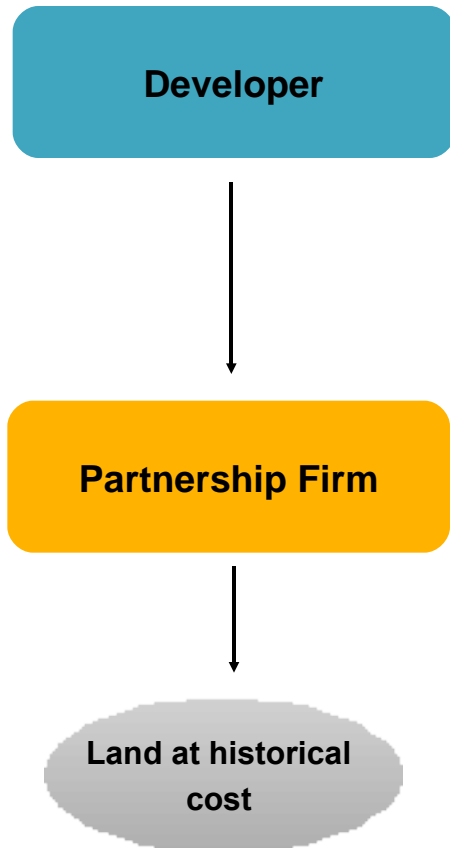


CASE STUDY # 2



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CASE STUDY # 2 – FACTS



- A Developer currently holds certain land in a partnership firm at historical cost
- The Developer proposes to partner with a strategic investor to develop the land
- Potential strategic overseas investor (“Investor”) is identified
- The parties contemplate a 50:50 Joint Venture (“JV”) for construction of a commercial project encompassing a business hotel, mall and office space
- Project to be executed by a jointly owned SPV
- Investor to invest Rs 50 crores for acquiring a 50% stake from the Developer
- Subsequent expenses to be funded equally by the Developer and Investor

CASE STUDY # 2 – KEY CHALLENGES / ISSUES

- Land sitting at historical cost
- Land currently held in a partnership firm
- Transfer of land to a company and transfer of shareholding in company to result in substantial taxes

Devising a tax efficient structure for transfer of land to a Company

Devising a tax efficient structure to enable the Developer to take out Rs 50 crores



CASE STUDY # 2 – POSSIBLE OPTIONS / SOLUTIONS

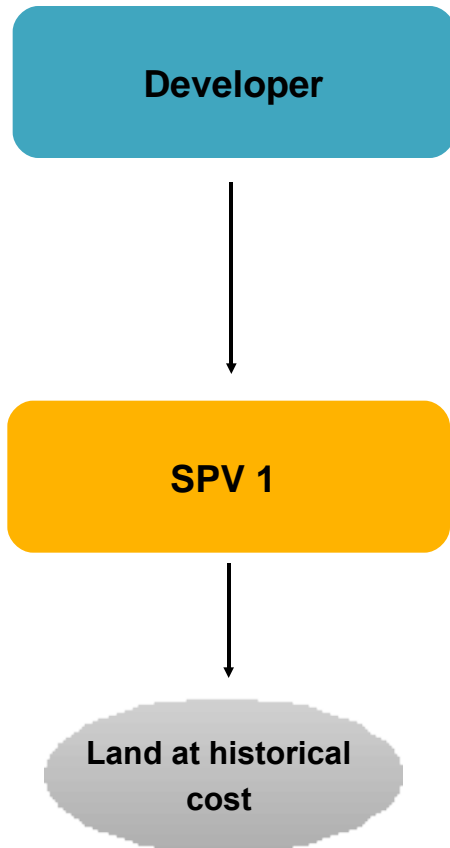
Possible solutions	Objective	Key challenges	Key benefits
Convert the existing partnership firm into a private limited company under Part IX of the Companies Act	Facilitate investment by the foreign investor into the SPV		<ul style="list-style-type: none"> • No Capital gains on conversion under Part IX of the Companies Act • No stamp duty cost on conversion
Step up the value of the land and transfer the revaluation amount into the partners current account	Facilitate cash out of the developer in a tax efficient manner		<ul style="list-style-type: none"> • No capital gains on revaluation of the land and cash out by the developer

CASE STUDY # 3

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CASE STUDY # 3 – FACTS

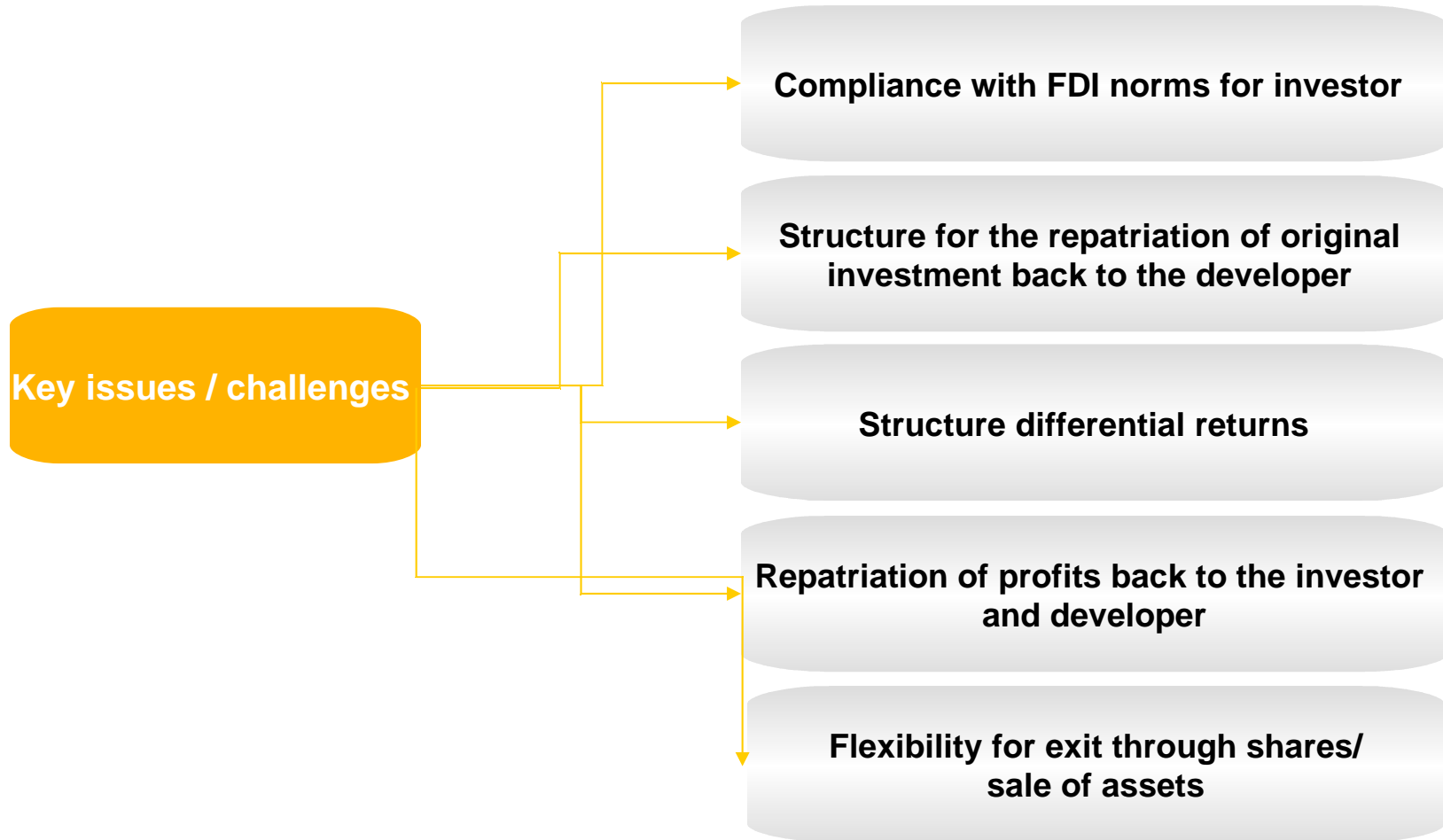


- A Foreign Company (“Investor”) proposes to invest in an IT park in India in a Joint Venture with an Indian Developer (“Developer”)
- Land for the proposed development was held in a Special Purpose Vehicle (“SPV1”) at Historical Cost (say Rs 100) that was held 100% by a Third Party.
- The Developer has procured 100% stake in SPV 1 from the Third Party at market value of the land (Say Rs 1000)

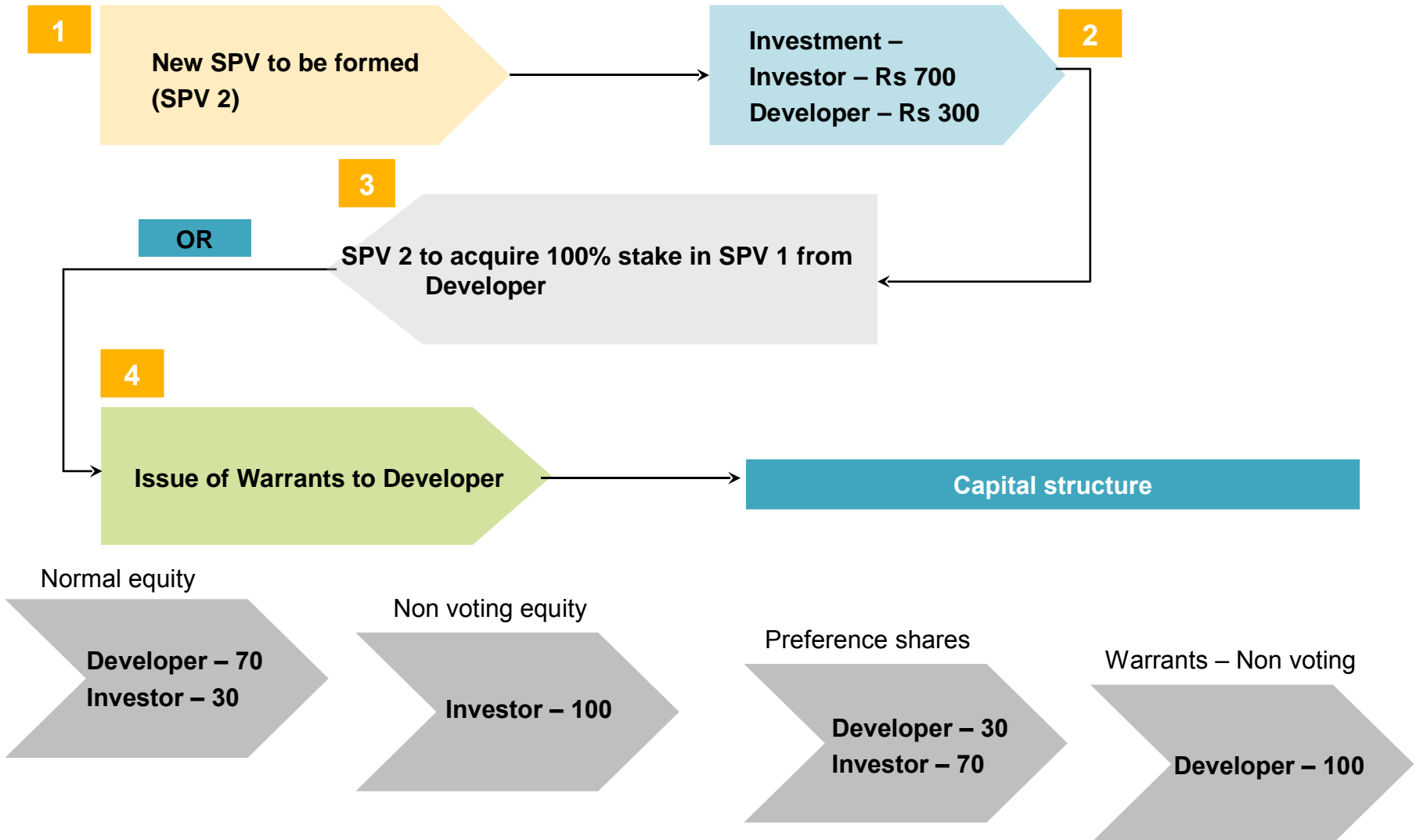
CASE STUDY # 3 – KEY COMMERCIAL TERMS

- Investor to initially contribute 70% of the market value of the land (Rs 700) for a 30% equity stake in the project
- Developer to withdraw his share of the initial contribution immediately
- Subsequent contributions to be made by the Developer and Investor in the ratio of 70:30
- Returns to be shared by the Developer and Investor in the following manner:
 - Up to 25% IRR – In the ratio of 30:70 between the Developer and Investor
 - Between 25% and 30% IRR - In the ratio of 50:50 between the Investor and Developer; and
 - Above 30% - In the ratio of 70:30 between the Developer and the Investor

CASE STUDY # 3 – KEY CHALLENGES / ISSUES

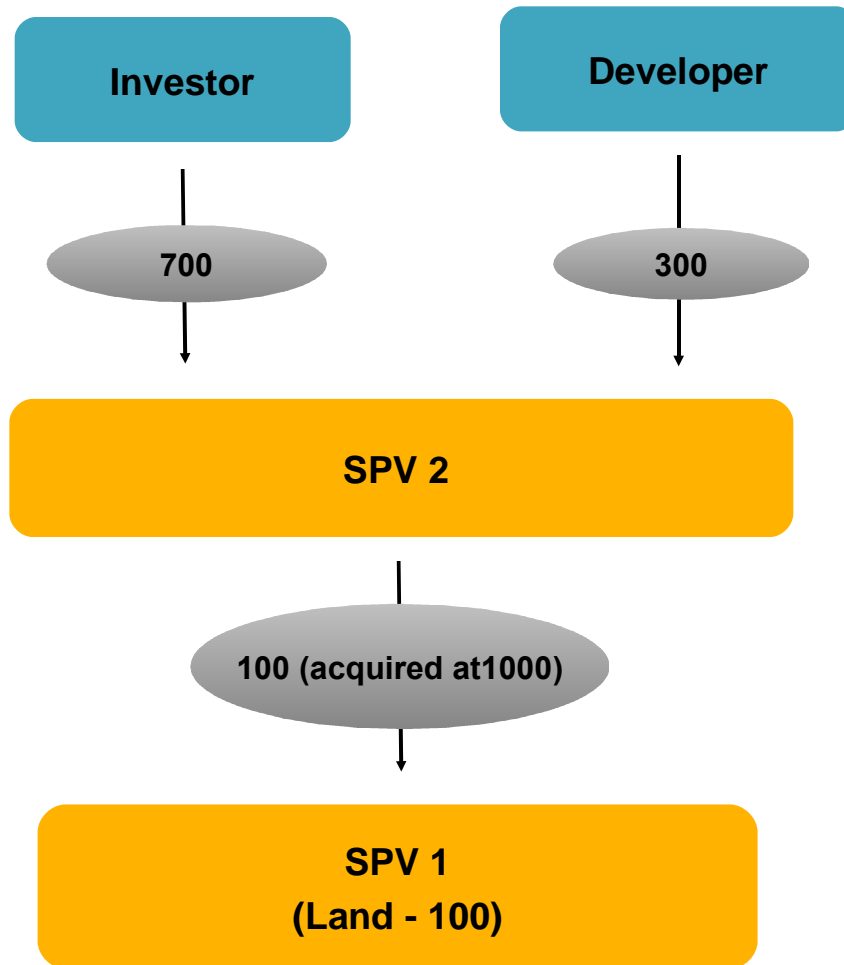


CASE STUDY # 3 – POSSIBLE OPTIONS / SOLUTIONS



CASE STUDY # 3 –

POSSIBLE OPTIONS / SOLUTIONS (contd...)



CASE STUDY # 3 – SHARE CAPITAL OF SPV 2

Particulars	Amount	Percentage	Percentage
EQUITY SHARE CAPITAL	49		100%
Equity Share Capital (With voting rights)	21	100%	
Investor	6.3	30%	13%
Developer	14.7	70%	30%
Equity Share Capital (With no voting rights)	28	100%	
Investor	28	100%	57%
PREFERENCE SHARE CAPITAL	951	100%	100%
Investor	665.7	70%	70%
Developer	285.3	30%	30%

CASE STUDY # 3 – SHARE CAPITAL OF SPV 2 (contd..)

Particulars	Amount	Amount	Percentage
WARRANTS			
Warrants (Class A)		19.6	100%
Developer	19.6		100%
<i>On achievement of 25% IRR, these warrants to convert into equity share capital (without voting rights) of 19.6, thereby the overall equity capital ratio being altered to 50:50 between the Developer and Investor</i>			
Warrants (Class B)		45.7	100%
Developer	45.7		100%
<i>On achievement of 30% IRR, these warrants to convert into equity share capital (without voting rights) of 45.7, thereby the overall equity capital ratio being altered to 70:30 between the Developer and Investor</i>			

Note : *The issue price and conversion ratio of the warrants could be determined separately*

CASE STUDY # 3 – SHARE CAPITAL OF SPV 2 (contd...)

Share capital after conversion of all warrants

Particulars	Amount	Percentage
EQUITY SHARE CAPITAL	114.3	100%
Investor	34.3	30%
Developer	80	70%
PREFERENCE SHARE CAPITAL	951	100%
Investor	665.7	70%
Developer	285.3	30%

CASE STUDY # 3 – SOME RELEVANT POINTS

- In the proposed option / solution the warrants are over and above the investment proposed by the Developer and Investor – issue price and conversion ratio of the warrants could be determined
- SPV 2 holding SPV 1 could require an FIPB approval
- In which SPV the development would be carried out
- Additional tax costs, in case development is carried out in SPV 1
- Transaction cost (stamp duty and property taxes), in case land is transferred from SPV 1 to SPV 2
- Use of Partnership firm to achieve step up of cost and mitigate the need for FIPB approval



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