Careful structuring key to international joint venture success

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Research shows that joint ventures grow at twice the rate of mergers and acquisitions – here's how to set one up.

Joint ventures can have benefits for businesses

There are three ways to grow a company – you can grow organically, acquire a company or partner with another firm. An international joint venture falls into the third category.

Tom Wheeler, managing director of IR Global, a professional services network that provides advice to companies and individuals says there are many

reasons why a company might consider entering into an international joint venture with one or more other parties.

He says a firm may do this for three reasons:

- Trying to break into a new market and have need of a partner with local knowledge or contacts.
- Tendering for a demanding project and need the resources, skills and experience offered by another organisation.
- Hoping to grow and scale up its operations quickly and want to share the financial burden and risk with another business with similar objectives.

Whatever the exact reason, a joint venture (JV) can often prove to be the ideal way of achieving a stated goal. Management consultancy Bain & Company carried out a survey of 253 joint ventures between 1995 and 2015, finding that, overall, the value of JVs grew at twice the rate of M&A deals. The US joint ventures they studied, yielded a 17 per cent return on investment, compared with an industry average of 11 per cent.

This all sounds like a strong argument in favour of JVs, but there are significant complexities within this form of collaboration that, if not addressed correctly, can lead to failure.

Wheeler says, 'The first thing to consider, before any structuring takes place, is due diligence and a thorough assessment of the other partners involved. Often those partners are so excited about bringing synergies together, while sharing knowledge and skills that they forget to think carefully about whether the organisations involved will work well together.'

Risk analysis

It is best practice to implement a risk analysis as early as possible, in order to identify potential risks and how to minimise them. A partner-fit assessment is also crucial, based on pre-defined criteria such as decision-making styles, strategic intent and culture. This is particularly relevant if the JV is international with parties from different countries working together.

Once international JV partners have been properly assessed and cultural differences understood, the next consideration is structure.

Tax and the delivery of profit is a major driver of structure, and can influence whether the JV uses a formalised vehicle in another jurisdiction, or an informal contractual arrangement with no new legal entity. Formalising the

structure will require JV partners to extract profits across borders and does often involve the use of offshore planning.

Joint venture tax implications

He explains, 'If a UK-based company invested in Spain via a formalised Spanish company, they would be subject to 25 per cent corporation tax. Since the same tax in the UK is much lower, they may prefer to enter into a less formal contractual arrangement and not be subject to Spanish tax.'

He adds: "Spain has tax treaties with many countries that can reduce the tax paid on dividends, but if the JV is structured via a 'tax haven' then it is much more difficult to move money around.'

'Structures that involve offshore jurisdictions may appear to be more tax efficient, but this needs to be analysed carefully on a case-by-case basis.'

Double taxation agreements are crucial, according to Ross Koffel, a commercial lawyer in Sydney and an IR Global member, who offers advice on tax efficient structures that can be implemented if a formal JV vehicle is used, with each partner taking an equity stake.

'Partners can setup a unit trust and become beneficiaries by owning units. A trustee company, controlling the unit trust, would be owned by the partners, enabling the unit holders to receive profits directly without the unit trust being taxed. The parties are then responsible for their own tax and can each have different structures.'

He says that any tax paid in Australia is claimed as an input credit in their own country if that country has a double tax treaty with Australia.

'Parties can also advance money by way of loan and receive interest payments, subject to a relatively low rate of withholding tax. The amount of the loan would be subject to thin capitalisation rules, which would normally allow the majority of the money to be invested by way of a loan.'

Choice of governing law is also crucial in the formation of international JVs and should be decided prior to the commencement of the relationship. A corollary to this is the apportionment of liabilities between partners in case of a dispute, and a clear process of dispute resolution – enforced via contractual clauses.

Ross Koffel is clear that structuring the collaboration as a JV agreement, rather than a partnership, allows JV partners to avoid full legal liability for the actions of the joint venture, because the agreement defines who bears the various liabilities and to what extent.

He says, 'If the JV is a partnership, then a third party can hold all partners jointly and severally liable.'

Bosco de Gispert Segura regularly helps clients involved in temporary joint ventures, using a specific Spanish vehicle called the unión temporal de empresas (UTE). Spanish legislation states that structuring a JV as a UTE automatically makes all partners jointly and severally liable for any dispute with a third party. As such internal apportionment of liabilities is crucial.

He says, 'It's very important to set up Chinese walls within the UTE to deal with any liability. A whole system of clauses designed to limit and distribute liabilities are required. This provides a mechanism so that once a claim is received it is dealt with efficiently according to the contract.'

In conclusion, it is clear that successful joint ventures require rigorous due diligence around culture, aptitude and experience, in order to establish partner suitability. Beyond that, they need to be structured very carefully for tax efficiency, liability apportionment and dispute resolution.

The most important factor in maximising returns is the solidity of the internal relationship between partners. As many specific clauses as possible should be added before the JV begins, since, the more foresight that is employed, the less chance there is of damaging conflict and unplanned liability. And the more chance there is of returning a healthy profit.

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