

International Webinar Series

International Joint Ventures: Some Tricks and Traps of the Trade

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Agenda Topics

- Overview
- Pros/Cons of JVs
- Key Business Issues
- Dispute Resolution Issues
- Key Tax Issues
- Sample JV Structures
- Conclusion

Overview

- “Inbound” JVs: US situs with foreign partner
- “Outbound” JVs: foreign situs with US partner
- Type of entity (corporation or flow-through)?
- SPV: single JV deal, just *that* entity?
- Potential for future expansion, subsidiaries?
 - Other markets, countries
 - Other products/services
 - Other partners/investors
- NO “one size fits all” arrangement

Joint Ventures – Overview

Joint Venture Ownership – Some Pros:

- Knowledgeable, equally committed local partner
- Enhanced ability jointly to navigate local laws and customs
- Improved access to financing, distribution channels, customer potentials
 - Faster than conventional franchise roll-outs locally
- Sourcing advantages, customs/import clearance benefits with sophisticated local partner

Joint Ventures – Overview (cont.)

Joint Venture Ownership – Some Pros (cont.):

- Can achieve early market access, distribution benefits in a rapidly-expanding market
- Equity strength; shared investment costs/risks
- National/regional image enhancement
- Successful working relationship provides possible springboard for other joint activities, joint territorial expansion

Joint Ventures – Overview (cont.)

Joint Venture Ownership – Some Cons:

- A separate legal entity
- It is “joint” ownership; you are not wholly or completely “in charge”
- JV’s assets may be located in a state or geography where you do not have the “home field advantage”
- Partners to commit capital and to ‘invest’ (funds, management energy, etc.) in JV when the investment may not meet hurdle rates, etc.

Joint Ventures – Overview (cont.)

Joint Venture Ownership – Some Cons (cont.):

- The form/amount of such “investment” can vary, risks abound in terms substandard profitability, cash flows may be lower than projected, market and political environment can change, etc.
- Must determine how each partner will control its “brand” and its IP (in JV’s “territory”)
- Financing expansion, governance issues, exit and windup, control of operations, expansion, administration must be addressed upfront (see “Issues”).

Joint Venture Issues (cont.)

- Staged Expansion, “trial period” for relationship?
 - How is “success” defined in order to expand?
 - Agree upfront: limited geography, limited products / services, minimum profitability or cash flow milestones (per stated period), etc.?
- Funding / Capital Investment Issues
 - How does each JV partner fund – and value – their share?
 - Are Debt / Equity financing levels agreed?
 - What if one partner refuses/is unable to contribute prorata share of additional cash needs in future? Automatic dilution? Buy / Sell?

Joint Venture Issues (cont.)

- Ownership Issues
 - How are equity, voting rights, cash flows/preferences split?
 - Do you use an SPV to hold or license in technology or IP, or will IP be contributed as “equity” to the JV (which owns it afterwards)?
 - How should you hold your equity interest in the JV?
 - Are you already a flow-through entity for US tax? Do the parties agree that the JV should be, too?

Joint Venture Issues (cont.)

- Governance
 - Board control, constitution of Board, representation of owners
 - Differences between Board and shareholder voting requirements
 - Class voting and negative control rights? (If so, which issues, what voting thresholds?)
 - What happens in case of deadlock or irretrievable breakdown / divergence of interests?

Joint Venture Issues (cont.)

- Constitution of Manager or Board:
 - Is JV to be a manager-managed or member-managed partnership?
 - Number of “directors” or manager group?
 - Who appoints/designates “Chair”? Does that designation rotate?
- Appointment of key JV officers:
 - Who appoints which ones?
 - How often do such appointments rotate?
 - What is the scope of those officers’ authority?

Joint Venture Issues (cont.)

- Appointment of key JV officers (cont.):
 - What is the duration of their terms/appointment?
 - Can such officers be removed before their term is up? Under what circumstances?
 - Are qualifications for partners' appointments/nominations consistent?
- Who appoints the JV's advisors (e.g., statutory auditors, tax return preparers, consultants)?
 - Do appointments rotate between JV partners?

Joint Venture Issues (cont.)

- Employees/Loaned Employee issues
 - Will one / both partner's personnel be assigned/seconded to the JV, even temporarily?
 - Must ensure all employer/employee taxes and withholdings are correct
 - Is there a need for non-US employees or contractors for the JV?
 - Must follow visa requirements, work limitations as well as employee/employer tax requirements
 - BEWARE: "Permanent Establishment" / signature authority issues for secondees to JV

Joint Venture Issues (cont.)

- Exit / Termination Issues:
 - Time Certain, Stated Event, Deadlock?
 - How are JV's IP, inventory, assets, customer lists, etc., to be allocated?
 - Do separate contracts of partners have separate termination rights, cross default provisions?
 - Buy-Sell (or put) of ownership interests vs. actual liquidation of JV entity?
 - What happens in the event of death, incapacity or disability, or bankruptcy of partner?

Joint Venture Issues (cont.)

- Exit / Termination Issues (cont.)
 - Agreed independent valuation firm to resolve disputes?
 - Reconciliation, distribution of cash/property obligations at termination
 - Liquidation process, timing, notice rules under local law
 - Consequences of previous or final tax return filings/obligations if disputed by tax authority?

Joint Venture Issues (cont.)

- Dispute Resolution
 - Concern about local partner’s “home court” advantage, applicable law, local litigation rules?
 - Consider “three-step” dispute resolution process:
 - (1) required negotiation of principals, then
 - (2) mediation (if agreed), then
 - (3) arbitration / litigation
 - Arbitrate in agreed neutral forum / state with neutral, qualified arbitrator(s)?
 - What arbitration rules apply? UNCITRAL? AAA?

Joint Venture Issues (cont.)

- Key Tax Issues
 - Will JV be a “corporation” or flow-through entity for US tax? Foreign tax?
 - Will JV be a domestic (US) or foreign entity?
 - Does a tax treaty apply?
 - If a partnership, how will capital and profits be split? Is there a need for special allocations? What are the consequences?
 - If JV is US partnership/LLC, foreign partner needs to understand US tax impact of sale of JV interest under new US law (§ 864(c)(8))

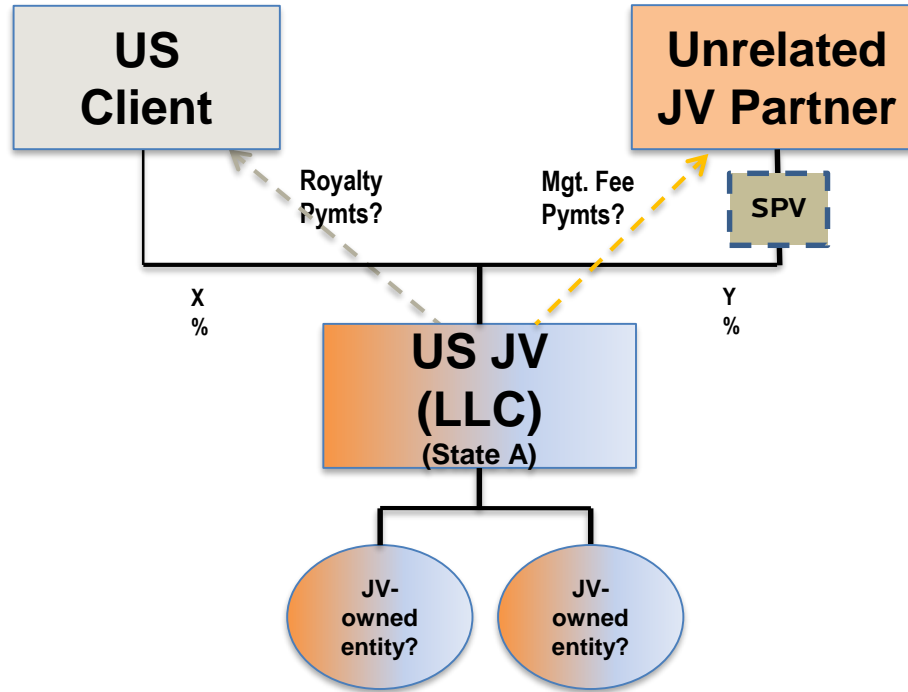
Joint Venture Issues (cont.)

- Key Tax Issues (cont.)
 - If U.S. JV with foreign partner(s), applicable forms required (W-8BEN or W-8BEN-E) with JV
 - If JV is a foreign corp., is it a CFC or PFIC?
 - Beware of US “control” – of vote, value or Board
 - Debt/Equity funding ratios: US “thin cap” rules
 - Apply to “corporations,” *not* partnerships
 - What are applicable foreign JV rules?
 - US \geq 10% corporate owners of foreign corp. do NOT have income from foreign dividends

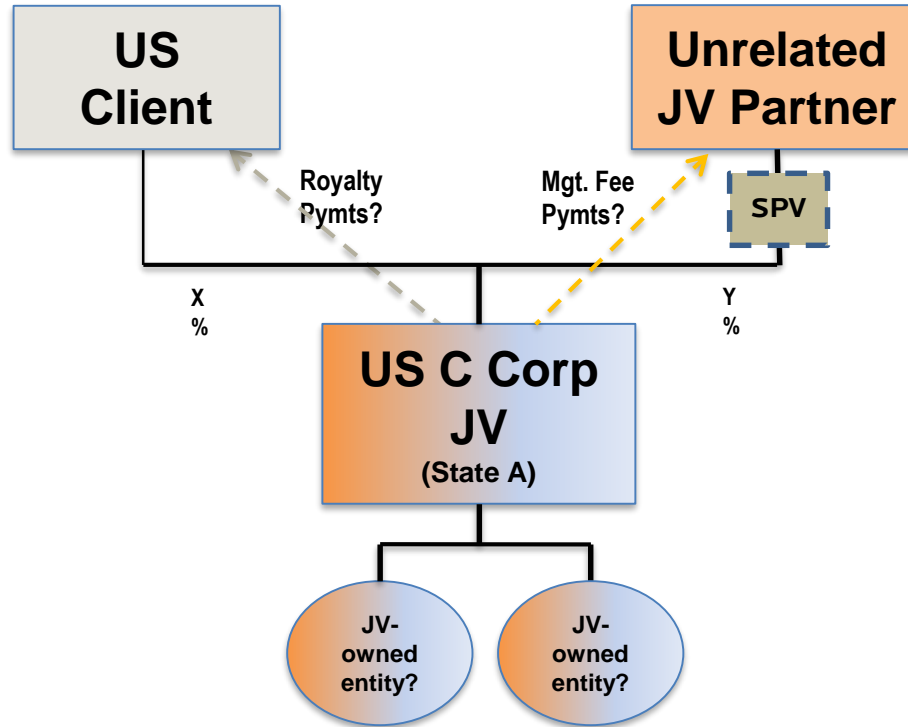
Joint Venture Issues (cont.)

- Key Tax Issues (cont.):
 - BEWARE of “equalization” of cash flows:
 - Example: royalty to one partner matched by mgt services fees paid to the other partner
 - Contracts between partners, entity may be subject to transfer pricing rules...
 - Transactions between “related parties” that are attacked as non-arm’s length
 - Common control for “related party” determination may be less than “50%+”

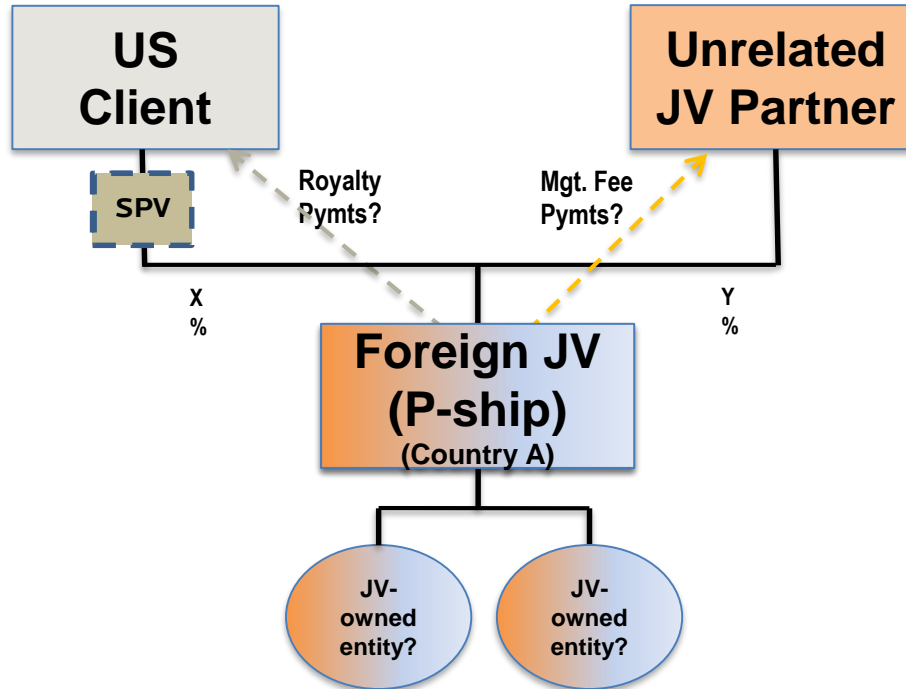
Sample **US** Joint Venture Structure - 1



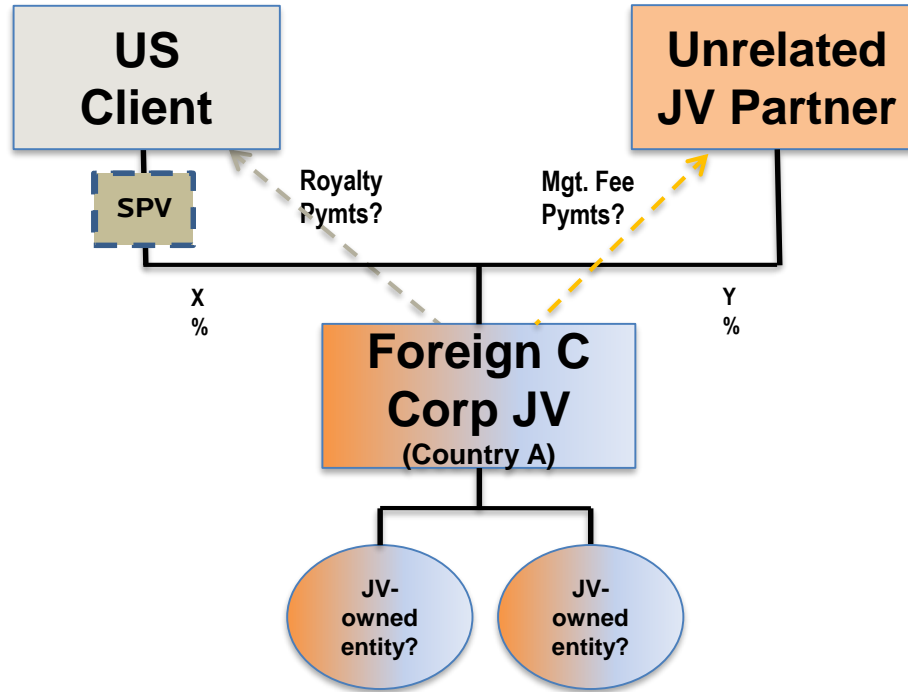
Sample **US** Joint Venture Structure - 2



Sample Int'l Joint Venture Structure - 1



Sample Int'l Joint Venture Structure - 2



Summary

- JVs are beneficial, symbiotic combination of the skills, experiences, funding, local knowledge, assets, products/services, supplier/vendor/customer relationships, technology and market reputations of the parties
- Structuring JVs can encompass creative provisions and solutions to issues
- JVs are creatures of contract and accordingly are very flexible

Summary (cont.)

- The “honeymoon” discussion of the opportunities initially may obscure various underlying key legal, economic and personnel issues
- Lawyers need to focus their client(s) on all the various issues and “what ifs” as soon as possible, and then ensure that those matters are discussed and agreed upfront by the principals
- Equitable and fair dealing, plus open communications, can avoid small issues escalating out of control in the future

Today's Presenter



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Thanks!