

NovioTax

High level tax and legal considerations in setting up
and maintaining a long-term European JV

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About NovioTax

NovioTax is a Dutch research-based tax advisory firm, which members have many years (20+) of experience in AAA advisory firms and have strong connections in the UK, US and Luxembourg. In our DNA we are a research based advisory firm that is programmed to excel in quality and service.

Through research, we develop our intellectual capital. For instance, every member of NovioTax is required to participate in research activities. We believe that through the use of research we will discover new ideas and opportunities that support our clients.

We also strongly believe in a superior service. We are dedicated to invest in getting to know our clients, listening to them and enabling that our advices add value to clients. Our aim is to actively leverage our experience and knowledge for our clients as transparently and accessibly as possible.

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Setting up and maintaining a long-term European JV

Investing in Europe comes with various aspects to take into consideration. For instance, investing in a joint venture in the Netherlands has numerous opportunities on both tax and legal level that can be used to gain an advantage for your company. In light of this, the following presentation contains information on specific subjects like general organizational aspects, IP rights, R&D regime, up-streamed returns and an exit approach.

Key terms

The Joint Venture partners X, Australian resident, Q, UK resident, Y BV, NL resident and Z, Austrian resident wish to establish a joint venture (Joint Venture or JV), which will involve incorporating a new limited liability company (JV Company) to develop and supply telematics and associated connected motoring technology and services to motoring clubs and other third parties in Europe (JV Services).

The vision of the JV is to establish a compelling, market leading connected motoring capability which will leverage the global network of motoring club initiatives wherever possible. This will be for the benefit of the JV Partners and indirectly for their customers and members and other associated clubs. A relationship with a focus on facilitation of ongoing reinvestment is sought in order to facilitate scale in the development and operation of connected member services. Hence, the JV Partners have a long-term focus.

The JV Partners wish to develop a funding framework that facilitates the financial viability of the JV Company, and equity in the relative contribution of the JV Partners, of which key elements include:

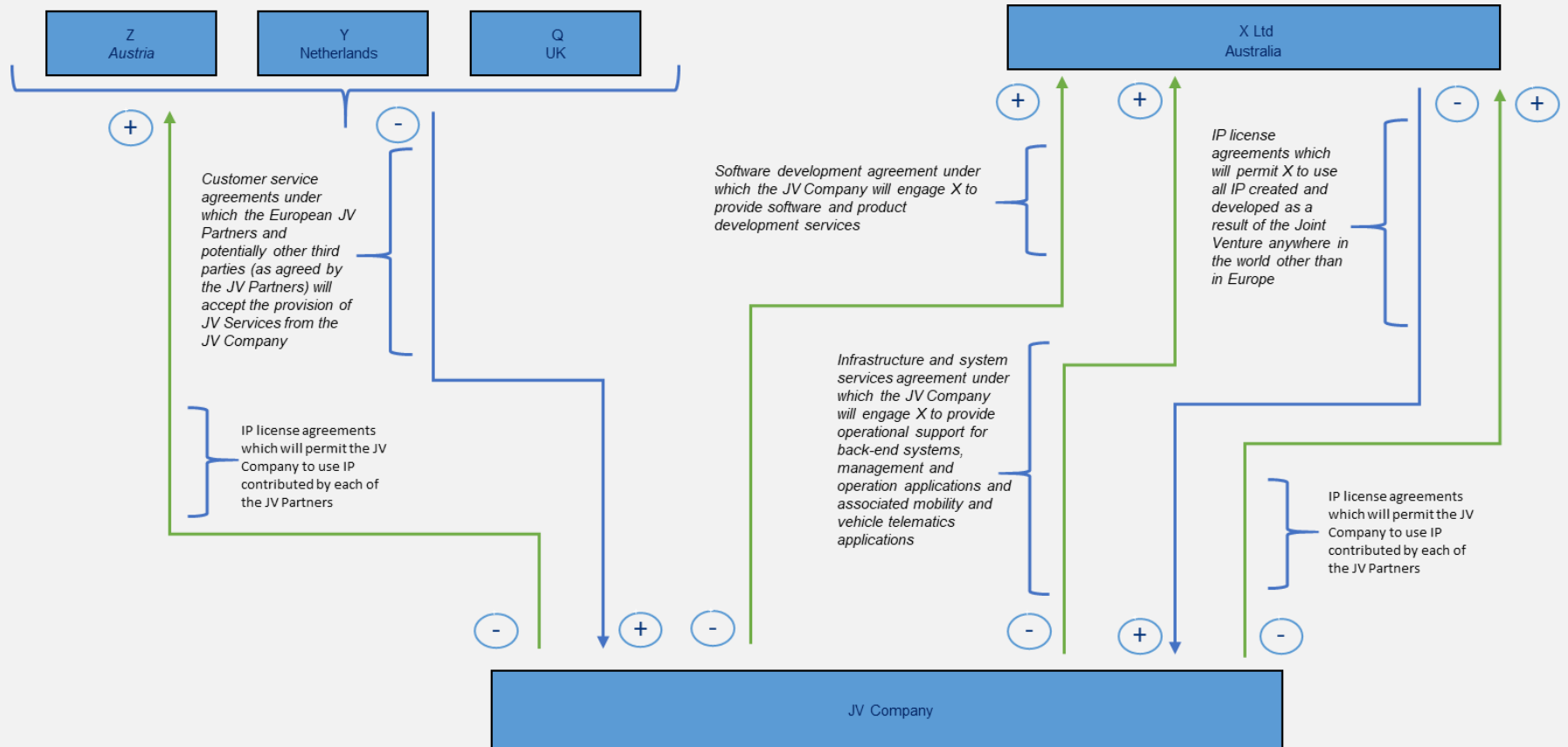
- I. an initial injection of capital by the JV Partners which will be sufficient to address the establishment costs of the Joint Venture and initial working capital requirements;
- II. contribution of relevant intellectual property (IP) by X, which will provide the foundation for the capability of the JV Company, in addition to relevant IP held by Q, Y and Z; and
- III. the European JV Partners' commitment to purchase certain services from the JV Company on a preferential basis, including customer contracts which will be established concurrent with the establishment of the JV Company.

Organization overview

The JV Company's founding shareholders are the JV Partners, and the JV Partners will agree the jurisdiction of incorporation of the JV Company and its tax treatment. The parties will negotiate and agree the following documents prior to 30 July 2015:

- I. shareholders' agreement which will deal with the ownership and governance of the JV Company and the conduct of the business of the Joint Venture (Shareholders' Agreement);
- II. IP license agreements which will permit the JV Company to use IP contributed by each of the JV Partners; and X to use all IP created and developed as a result of the Joint Venture anywhere in the world other than in Europe;
- III. administrative services agreement pursuant to which the JV Company will secure business support services from some or all of the JV Partners;
- IV. software development agreement under which the JV Company will engage X to provide software and product development services;
- V. infrastructure and system services agreement under which the JV Company will engage X to provide operational support for back-end systems, management and operation applications and associated mobility and vehicle telematics applications; and
- VI. customer service agreements under which the European JV Partners and potentially other third parties (as agreed by the JV Partners) will accept the provision of JV Services from the JV Company.

Structure example



Distinguishing IP rights

To start with the arm's length treatment of partnership contributions we note that we typically recommend clients to make a distinction in JV agreements between Background IP, Sideground IP and Foreground IP. Background IP is held by a partner prior to the commencement of the JV (and is usually listed in an Annex to the agreement), Sideground IP rights are generated by a partner during the term of the JV and Foreground IP arising from the project and including registered IP rights and IP rights that do not require registration (including software and software documentation developed as part of the project). In these cases each partner will remain the owner and will retain control of its Background IP and Sideground IP, but grants access rights to Background IP to the other participants to the extent needed to enable the carrying out of the R&D as described in the JV and at no costs. As a consequence, no additional agreements have to be entered into to exercise these Access Rights.

Tax perspective

From a tax perspective the treatment / interpretation is however not always clear. In the case at hand and (roughly) summarizing: X has the technology and know-how to develop telematics and the R, Q and the Z have the (preferred) right to supply services and associated connected motoring technology (derived from the developed telematics) to motoring clubs and other third parties in Europe. If our understanding of the Memorandum of Understanding is correct the costs and risks of operating the JV Company are pooled and shared amongst the participants based upon expected benefits from use of the results by the various participants. We expect that each participants proportionate share of the overall contributions "will be" consistent with the participants proportionate share of the overall expected benefits from the JV Company.

If the aforementioned understanding of the Memorandum of Understanding is correct we could in principle taken the position (based on the TP Guidelines) that contributions should be treated as capital contributions made by the participants in the JV Company and vis-à-vis deductible business expenses at the level of the JV Company.

Based on the assumption that such pooling between independent companies takes place on a cost-only basis, no mark-up for profit should be applied in determining and calculating the contributions. In order to provide comfort we could discuss this position on a no name bases with the Dutch tax authorities within a limited time-frame. If the outcome would be positive they normally would support the preferred approach selected in possible discussions with the tax authorities' of Australia, Austria and the UK (should this be necessary).

Treatment contribution of participants

To satisfy the arm's length principle the various contributions must be consistent with what an independent enterprise would have agreed to contribute under comparable circumstances. This means that contributions should be in proportion to anticipated and/or received benefits. If you need additional information about measuring anticipated benefits or establishing a comparison of the share of expected benefit vs. the share of costs do let us know.

Please note that if the participants decide to select the Netherlands as preferred jurisdiction to establish the JV Company government subsidies for R&D activities may, if structured properly, be significant (see hereafter: reduction of up to 30% of R&D labor expenses if structured properly) and may have an impact on participants' contributions. In day to day experiences we see that the position is taken that all participants, whether domestic or foreign, benefit from these subsidies.

Dutch innovation regime

As side-benefits in this approach we should also be able to apply (in principle) the innovation box in respect of Foreground IP at the level of the JV Company (to the extent the Netherlands are chosen as preferred jurisdiction) and simultaneously at the level of the participants existing preferential IP regimes can (in principle) be safeguarded in respect of Background IP and Sideground IP. (i.e. no transfer of ownership and / or discussions involving mixed ownership).

We finally note that new participants may obtain an interest in the JV Company to the expense of the Q, Y and the Z. In such a case, the existing participants transfer part of their interest to the new partner. This normally requires valuing the existing ownership interest and charging an arm's length compensation for the share in the anticipated benefits (buy-in payment). As alternative it could be decided giving no access to existing results to a newcomer or against an increased fee for a certain period of time. In these cases, no buy-in fee would be required.

R&D Tax benefits

An initial injection of capital by the JV parties is necessary to address the initial working requirements to develop the necessary infrastructure and software (based on the software development agreement and the infrastructure and system services agreement). In this respect we note that the Netherlands government (if structured properly) may pay a significant part of the wage costs of (Netherlands based) employees involved in R&D. This contribution is in the form of the payroll tax reduction. If structured properly the payroll tax reduction may reduce the R&D establishment expenses with 10 – 30%. In the case at hand both the Netherlands and the UK both offer R&D tax credits for capital investments. We expect however that these benefits will be limited since software companies typically tend to invest in R&D labor.

On a more general note we emphasize that the Netherlands government aims to stimulate (among others) software entrepreneurs to invest in R&D. Especially in the vicinity of Amsterdam software development plays a significant role in the economy. In this respect besides the aforementioned “front-end” payroll tax reduction for R&D employees that applies to expenditures incurred in the creation of IP, the Netherlands also has a “back-end” tax regime (innovation box) that applies to the income earned after the creation and exploitation of the IP. This regime (i.e. Netherlands innovation box) is designed to increase (a.o.) software investments (by not limiting its application solely to patents or other IP rights that are capable of being registered). The UK patent box however is limited solely to patents which are based on the European Patent Convention, and in line therewith national patent laws, often as such not patentable. Hence, we expect difficulties in obtaining tax benefits based on the UK patent box (to be checked with UK counsel). Please note that in order to benefit from these regimes (payroll tax reduction for R&D employees and innovation box) it is important that (at least) the proposed development takes place in the Netherlands.

Possible tax leakage

Based on the software development agreement and the infrastructure and system services agreement payments will be made from the JV Company to X Ltd. If the JV Company is based in the UK and assuming that the UK-Australian Double Taxation treaty applies, we expect some tax leakage (0% - 20%) on up streamed service payments especially if X Ltd is not able to credit UK withholding taxes. If the JV company qualifies as a Dutch tax resident we will not face tax leakage on said payments due to the absence of withholding taxes on royalty/service payments in the Netherlands.

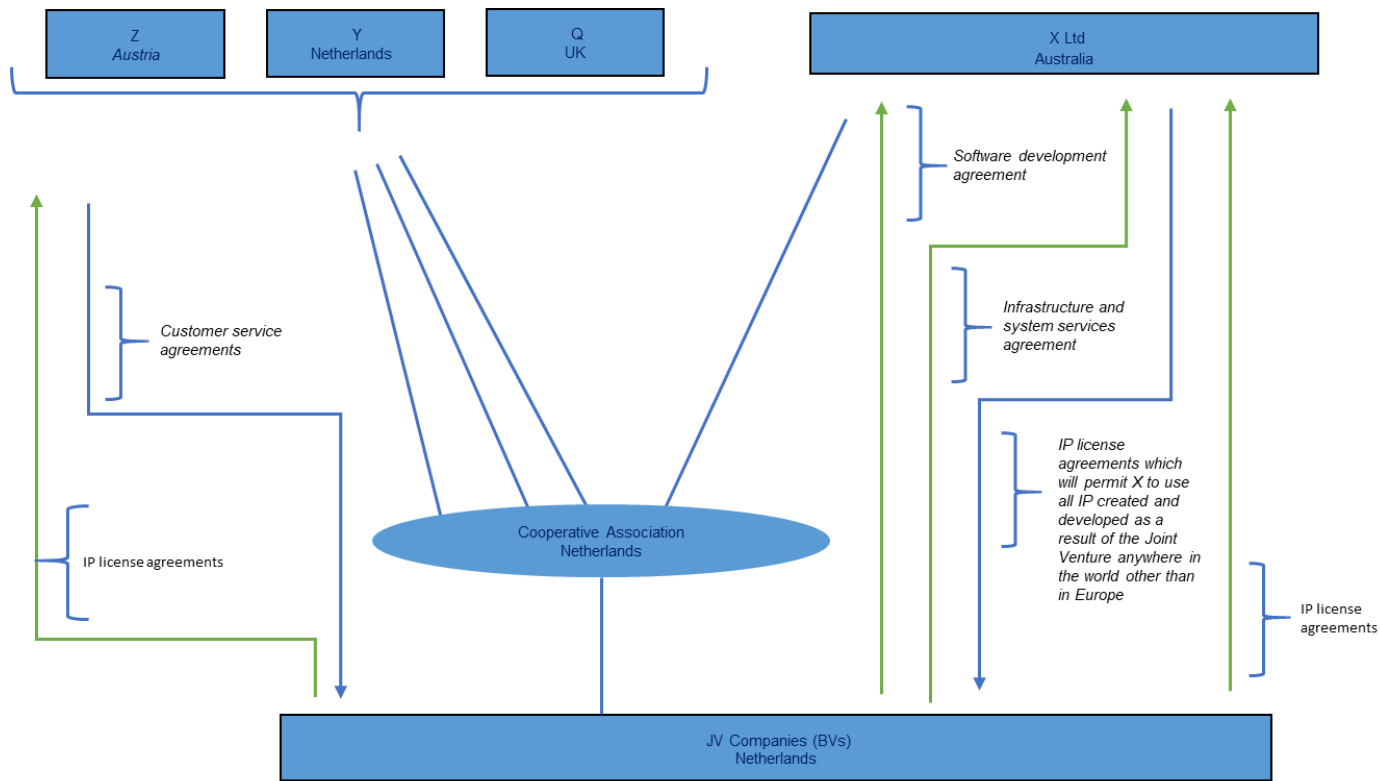
Up-streamed returns and exit approach

In the Memorandum of Understanding no emphasis has been given to (dividends) returns being up streamed. To avoid any tax leakage to the extent dividends are up streamed or in case of an exit scenario it could be considered to use a Dutch cooperative association as investment platform by the participants. Such cooperative association is generally regarded as a body corporate, has limited liability and is formed by participants that cooperate for their mutual benefit, which in the case at hand aligns with the Memorandum of Understanding (i.e. JV business is conducted by for the benefit of its members). Typically such cooperative associations are owned and managed by the people who use their services (which is also the case). In experiences obtained we often see that the JV business is conducted via a wholly owned subsidiary by the cooperative association for legal and tax purposes. Especially if parties have difficulty in determining and calculating the arm's length prices (shares service centers / contribution arrangements that involve partners in 3 -4 + jurisdictions) an investment platform that avoids tax leakage on hidden dividends is preferred (i.e. managing potential downsides). We would be happy to clarify in more detail.

It is widely recognized that the Netherlands offers an attractive investment infrastructure. Among other elements, this is due to the absence of withholding taxes on interest and royalty payments, its ruling policy and its tax treaty network. In the case at hand we could liaise upfront with the tax authorities to obtain comfort regarding the tax treatment. Topics generally covered are the arms' length principle in determining participants contributions, deductibility of expenses at the level of investors platform, non-application of a number of anti-abuse provisions and the innovation box application. Given the semi-public nature or at least semi-public origin of some participants (European motoring agencies such as for instance the Y) in direct relation with the business-to-consumer nature we recommend ownership structures that are sustainable (i.e. we are reluctant in advising exotic / hybrid tax planning) and well embedded within the economical framework.

With respect to the innovation box but also the UK patent box we note that some developments are expected with implementation in the course of 2016. Existing agreements will however probably be safeguarded during a 3 to 6 year transition period. If we however are observing an increase of R&D personnel and R&D expenses the downsides may be limited. In addition by setting up an ownership structures that matches with the economic rationale and is based on day-to-day activities of both the JV company and its participants', a number of Dutch domestic anti-abuse provisions are not likely to materialize (for instance article 17, paragraph 3, under b of the CITA and certain specific provision aimed at targeting abuse of Dutch cooperative associations).

Alternative ownership structure



- ✓ If the JV company qualifies as a Dutch tax resident we will not face tax leakage (at source) on service payments to X due to the absence of withholding taxes on royalty/service payments in the Netherlands
- ✓ To avoid any tax leakage to the extent dividends are up streamed or in case of an exit scenario it could be considered to use a Dutch cooperative association as investment platform by the participants.
- ✓ the Netherlands government (if structured properly) may pay a significant part of the wage costs of employees involved in R&D at the level of the JV Company. If structured properly the reduction may reduce the R&D establishment expenses with 10 – 30%.

NovioTax

NovioTax B.V. +31 (0) 24 352 96 90 info@noviotax.com www.novio.tax

