APPLEBY

PRACTICE UPDATE

WHY OFFSHORE CORPORATE STRUCTURING NEEDS TO BE ON THE AGENDA

Oliver Lawson

From the fast paced and cash constrained environment of start-ups to the expansion challenges experienced by more established growth companies, raising capital and entering new markets are key focal points for companies.

Typically for small to medium sized companies, consideration of corporate structuring, let alone offshore corporate structuring, has not been high on the agenda and generally assessed by "what works right now." As is now obvious in the global market, the big players are truly international companies that use offshore corporate structuring as a competitive advantage. To keep up, companies need to put corporate structuring on the agenda and ask themselves "what will provide an advantage going forward."

General Benefits of Offshore Structures

The general benefits of utilising an offshore corporate structure can include:

- **Access to global funding**: Offshore vehicles familiar to a company's target investors and financiers can attract a wider pool of global investors and tap into the considerable funds currently in the offshore market;
- **New market entry**: Gateway for international market expansion, facilitating both western companies' investment and expansion in developing markets and also acting as a base for companies in emerging markets to attract investment at home and expand to western markets;
- **Asset separation/protection**: Offshore ownership of IP can enable efficient international licensing and separation of core asset ownership from operating entities;
- **Stable and business centric legal systems**: Generally common law based jurisdictions that are recognised globally, they provide streamlined, stable and flexible legal processes for raising capital, investing in assets and ultimately exiting through mergers and acquisitions or IPOs;
- **Tax neutrality**: Financial benefits that come from tax neutrality on international earnings. Benefits from tax neutrality can come from no personal or company income tax, no capital gains and no inheritance tax on international earnings depending on the jurisdiction.

When selecting an offshore jurisdiction (more than one may be used) it is important to consider both current and future business objectives and understand which jurisdictions are favoured by your target future sources of capital and your target markets.

There is no single corporate structure that is best for companies at every stage of the funding cycle and a range of opportunities should be considered and aligned with the business's objectives.

Seed Capital

At the seed capital stage the corporate identity of the start-up becomes very important. Commonly at this point, a partnership or limited liability company is established in the founder's home jurisdiction. Even at this stage, establishing a simple offshore holding structure in which to raise funds and split the 'pie' is beneficial as it establishes from the outset an offshore identity that can become the home for IP being developed, a base for future international earnings and it creates an entity that will provide on-going flexibility.

Angel Investment

When looking to attract Angel investors (typically raising from US$100,000 to $600,000), establishing

As is now obvious in the global market, the big players are truly international companies that use offshore corporate structuring as a competitive advantage."

an offshore structure can be of itself a financial advantage in the business plan due to tax neutrality of international profits that might be forecast. In any event, such a structure will provide greater flexibility to Angels to re-invest existing offshore funds in another offshore entity and widen the pool of potential Angels.

Venture Capital

At the VC stage (typically raising US$500,000+), corporate structuring will most certainly be put on the agenda. Companies that have already established the basis of an offshore structure are likely to benefit from reduced restructuring costs and the existence of the offshore identity. Even more so than with Angels, an offshore structure could attract VCs from a wider audience and tap into funds seeking offshore investments with a route to operations in target markets or industries. Importantly, a well selected offshore jurisdiction will provide flexibility to set-up stock structures that are desired by the target VCs.

IPO and Exit

Companies and investors who have planned their offshore structure ahead can typically leverage, at a lower cost, the full benefits of liquidating their equity and exiting through the sale or merger of an offshore entity, or by raising further capital and partial exit by way of IPO and public trading. Offshore entities also offer a relatively flexible capital structure as to conversion rights, super voting rights and employee options pre and post IPO which are helpful to investors in IPO's.

Creating a new offshore structure is also common at the IPO stage. In Asia particularly, usually the first step for an IPO is to establish an offshore holding structure and to utilise an offshore vehicle to access international public markets. The offshore vehicle then acquires, or acquires control, over the relevant operating company. By way of example, typically for IPO structures from the People's Republic of China (**PRC**), Wholly Foreign Owned Entity (**WOFE**) structures are used to capture most of the economic benefit of PRC operators while protecting the economic interests of the offshore investors.

Market Expansion

At any point in the funding cycle where companies are looking to raise funds to facilitate expansion across international markets, or even simply operate in new markets, offshore corporate structuring can be a valuable tool for all sides. Offshore structures can be leveraged by companies in developing markets to attract international investors by providing a vehicle that is understood by investors and provides the necessary asset protection, share structures and tax structure required by the investors. Depending on the target market for entry, key benefits of offshore structures go beyond the immediate financial benefits of tax neutrality on international profits and can provide an actual avenue to do business in restrictive markets and protect companies from some of the inherent jurisdictional risks of such markets.

CONTACT

Cayman Islands
Oliver Lawson
Associate
Corporate & Commercial
+345 814 2792
olawson@applebyglobal.com

Co-written by Simon Raftopoulos, a partner and the Group Head of Private Equity in the corporate and commercial practice group of Appleby (Cayman) Ltd.