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Myanmar Focus Group Client Alert: Structuring Joint Ventures in Myanmar: Threshold Considerations

With the recent opening up of the Myanmar economy, there has been a rush of activity from companies around the world to this dynamic new market. As these entities have evaluated investment opportunities in Myanmar, they have also sought to identify suitable local partners for their business ventures. The recent Foreign Investment Law contemplates that investments in certain industries can only be made in conjunction with a local Myanmar partner. In addition, many new entrants to the Myanmar market have taken a view that it is prudent to include a local partner in Myanmar ventures to ease startup and country risks associated with this frontier economy.

We set out in this client alert several key legal and commercial considerations that may be of interest to global companies and financial institutions that are preparing to establish joint ventures with a local partner in Myanmar.

KEY STRUCTURAL ISSUES

U.S. Myanmar Sanctions Considerations

The identity of the Myanmar-registered “local” partner is one to be considered seriously. While Myanmar itself has recently emerged from the shadow of a robust international sanctions regime, U.S. sanctions are still applicable to a number of Myanmar nationals and their business activities.

As originally promulgated beginning in 1997, the U.S. Myanmar sanctions generally prohibit (a) new investment in Myanmar by U.S. persons or the facilitation by U.S. persons of new investment in Myanmar by foreign persons and (b) exportation or re-exportation to Myanmar of financial services from the United States or by U.S. persons. Additionally, the United States has blocked the property and interests in property of certain Myanmar individuals and entities, making it unlawful for U.S. persons to engage in any dealings with or in the property or interests in property of such individuals or entities.

In recognition of recent reforms enacted by Myanmar's government and in order to encourage further economic modernization and political reform, the U.S. in 2012 and again this year eased certain of the Myanmar sanctions. Specifically the U.S. Department of the Treasury, Office of Foreign Assets Control ("**OFAC**") issued exemptions to the Myanmar sanctions in the form of General Licenses Nos. 16, 17, and 19 that generally permit U.S. persons to engage in the following activities that were originally prohibited:

- OFAC General License No. 16 authorizes the exportation or re-exportation of financial services to Myanmar, directly or indirectly, from the United States or by a U.S. person, but does not authorize the provision of financial services to the Myanmar Ministry of Defense or to any state or non-state armed group or to any entity in which any of the foregoing owns an interest of 50% or more.
- OFAC General License No. 17 authorizes new investment in Myanmar by U.S. persons, but does not authorize new investment in connection with any agreement with the Myanmar Ministry of Defense or with any state or non-state armed group or with any entity in which any of the foregoing owns an interest of 50% or more. General License No. 17 requires that any person engaging in a new investment in Myanmar that exceeds, in aggregate, \$500,000 must report certain information about the investment to the U.S. Department of State. General License No. 17 also requires that any person engaging in new investment in Myanmar pursuant to an agreement with Myanma Oil and Gas Enterprise (MOGE) notify the U.S. Department of State within 60 days of making such investment.
- General License No. 19 authorizes transactions involving Asia Green Development Bank, Ayeyarwady Bank, Myanma Economic Bank and Myanma Investment and Commercial Bank, but does not authorize any new investment in or with such entities, the exportation or re-exportation of financial services, directly or indirectly, to the Myanmar Ministry of Defense or to any state or non-state armed group or to any entity in which any of the foregoing owns an interest of 50% or more or the importation into the United States of jadeite or rubies mined or extracted from Myanmar or articles of jewelry containing such jadeite or rubies.

Notwithstanding the authorizations provided under the general licenses referenced above, U.S. persons remain prohibited from engaging in any activities in Myanmar or with a Myanmar person that would involve an individual or entity whose property and interests in property have been blocked by the United States. The names of such persons are published by OFAC on its Specially Designated Nationals and Blocked Persons List (the "**SDN List**").¹ With certain exceptions, U.S. persons are prohibited from transferring, paying, exporting, withdrawing, or otherwise dealing in the property

¹ The SDN list is publicly accessible online at: <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.

and interests in property of an individual or entity listed on the SDN List, as well as any entity in which an individual or entity listed on the SDN List owns an interest, directly or indirectly, of 50% or more, regardless of whether such entity is separately identified on the SDN List.

As such, to the extent that any U.S. entities or persons (including lenders, arrangers or investors) are involved in the proposed joint venture or any other form of the joint exercise in Myanmar, the relevant parties should ensure that any potential partner or counterparty in Myanmar is vetted against the SDN List to maintain compliance with the U.S. Myanmar sanctions regime.

The Onshore / Offshore Debate

A separate key structuring issue, once a local partner has been selected, is the jurisdiction of incorporation of the joint venture vehicle. While local investment laws may allow an operating license to be issued only to a Myanmar-registered entity, or in the oil and gas arenas a branch office (the “**Licensee**”), joint venture parties may consider holding the Licensee through an intermediary company organized under the laws of a country other than Myanmar (the “**Offshore JVCo**”). Whether the joint venture company is an Offshore JVCo or a Myanmar-registered joint venture vehicle (the “**Onshore JVCo**”) is a key structuring issue, as each presents a range of discrete legal and tax implications, which we discuss below.

ONSHORE JVCO CONSIDERATIONS

Corporate Law Basics

In the case of an Onshore JVCo structure, Myanmar laws and Myanmar regulators would directly govern the affairs of the entity, including its governance, funding and operations. For example, under the Myanmar Companies Act (“**MCA**”) any capital reduction by the Onshore JVCo would require a special resolution confirmed by a Myanmar court. Creditors of the Onshore JVCo would also be allowed to present an objection to any such reduction in capital.² Further, the Myanmar Investment Commission (“**MIC**”) would need to approve any reduction in the capital of the Onshore JVCo.

Joint venture members will need to examine the nuances of evolving Myanmar corporate law when assessing the viability of an Onshore JVCo structure. Of course, the jurisdiction of Myanmar law and Myanmar regulators is to a large degree unavoidable. The business being undertaken by the joint venture vehicle (and the Licensee itself) will in any event be subject to Myanmar laws and regulatory oversight. The question is whether this should also be the case for the joint venture vehicle holding company.

² MCA Section 58.

Call Options and Preference Shares

The foreign and local partners may wish to provide for future share transfers under pre-agreed conditions. It is possible to structure call options in Myanmar, but there are different ways of implementation. For example, call options can be included in the articles of incorporation of a company, integrated into the joint venture agreement, or they can be the subject of a separate deed altogether. Myanmar law allows for a number of options in this regard, with different profiles in terms of risk, confidentiality and enforceability. Structures involving call options raise capital gains tax issues for the transferring shareholder where the option is exercised.

The MCA also recognizes the possibility of preference shares and provides that “a company limited by shares may, if so authorized by its articles, issue preference shares which are, or at the option of the company are to be, liable to be redeemed”,³ subject to a number of conditions, particularly in relation to the redemption. The standard articles of incorporation used by the authorities in Myanmar, which in practice are adopted by most companies, provide that the share capital of such a company can be divided into different classes of shares.

Convertible Loans

Any change in the capital structure of a company that has received an investment permit from the MIC is subject to the MIC’s approval. In practice, this also applies to any conversion of a shareholder loan into equity capital. Appropriate amendments and notifications will need to be made to the Myanmar Central Bank to ensure that there is no confusion on the part of the relevant authorities as to the transaction effected, so as to manage any later queries should the foreign capital be repatriated in the future.

OFFSHORE JVCO CONSIDERATIONS

Local Partner Considerations

Using the Offshore JVCo structure may pose issues for local partners. Local companies owned by Myanmar citizens wishing to structure their investment into a Myanmar project through an offshore entity face a number of legal and tax issues. For example, in certain situations permission would be required under the 2012 Foreign Exchange Management Act. One possible structuring consideration would be for these local partners to invest directly in the Licensee, as opposed to the Offshore JVCo, but this approach raises a number of shareholder priority, dividend and voting issues.

Financing

In the case of an Offshore JVCo structure, consortium members may of course choose from any number of business friendly jurisdictions in which to incorporate their joint venture vehicle. Other than meeting certain corporate governance basics, it is also important to assess how incorporating the joint venture vehicle in a certain jurisdiction

³.....
MCA Section 105.

will impact the availability of financing sources. For example, export credit agencies (and even some commercial banks) will only lend to entities that are established in, or doing business in, a specified country or region. This is an important consideration to assess where financing for the Myanmar venture is proposed to be done at the Offshore JVCo level.

Investment Treaty Considerations

Myanmar is a party to the Comprehensive Investment Treaty signed by each of the members of the Association of Southeast Asian Nations (“**ASEAN**”) in 2009 (the “**Investment Treaty**”). The Investment Treaty provides investors from one ASEAN nation making investments in another ASEAN nation with protections against unjustified government action and expropriation and sets forth protocols for ensuring fair, equitable and most-favored nation treatment. The Investment Treaty also provides for resolution of disputes between investors from one ASEAN nation and member states by way of arbitration before the International Centre for Settlement of Investment Disputes. An Offshore JVCo would need to be incorporated in an ASEAN member state in order to avail itself of these protections.

Tax Considerations

The Licensee for most investments in Myanmar will receive a five year tax holiday under the 2012 Foreign Investment Law, in addition to a number of temporary customs duty and conditional income tax exemptions. It is also important to note that Myanmar does not apply a withholding tax on the payment of dividends. Therefore, creating a tax efficient structure is mostly a matter of planning for profit extraction, financing, and for a possible future divestment of all or a portion of the shares in the Offshore JVCo.

Alternative profit extraction measures such as shareholder loans may be considered to protect the Licensee from facing a trapped cash situation. Interest paid on loans, including shareholder loans, is normally tax deductible but the Internal Revenue Department has developed a practice of reassessing certain expenses, which may include interest on loans. Myanmar’s withholding tax on the payment of interest to an overseas recipient is 15%, which can be reduced to 10% (or even 8% in the case of interest paid on bank loans to a resident of Singapore) under Myanmar’s various double taxation agreements (“**DTA**”).

DTAs play a major role in protecting investors from Myanmar’s capital gains tax, which is 40% in the case of non-residents. However, Myanmar’s right to impose a capital gains tax differs amongst DTAs. Certain Myanmar DTAs do not provide for any tax reduction, such as the DTA with Vietnam. Other DTAs only provide for a limited exemption from capital gains tax for gains on share participations below 35%. Most robustly, the DTA with Singapore provides for a reduction of the capital gains tax to 10% (or an outright exemption in limited circumstances).

Capital Gains Tax	
No DTA (for example, amongst others, France, China, Russia and Australia)	40%
United Kingdom	No rule
India	40%
Korea	Exempt (participations of less than 35%) or 40%
Malaysia	Exempt (participations of less than 35%) or 40%
Thailand	Exempt (participations of less than 35%) or 40%
Vietnam	40%
Singapore	10% (or exempt)

CONCLUSION

In the coming months foreign investors looking to access the Myanmar market with a local partner will face a host of structuring issues. We have endeavored in this client alert to articulate some of these issues.

Please feel free to contact any member of the Milbank team to discuss any specific questions that you might have.

MYANMAR FOCUS GROUP

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any of the members of our Myanmar Focus Group.

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