

Introducing FDI in LLPs

The LLP Act 2008 allows foreign national and foreign LLP's to become partner in LLP but as per the Foreign Exchange Management Act 1999 and regulations and rules, foreign investment in LLP was not allowed, therefore it was necessary to prescribe a regulatory policy for allowing the FDI.

In September 2010, the Department of Industrial Policy and Promotion (DIPP) had issued a discussion paper on permitting FDI in LLPs, surrounding aspects / issues and invited comments thereon from various stakeholders.

Approval of FDI in LLPs - Conditions

In the above backdrop, the Cabinet Committee on Economic Affairs (CCEA), Government of India on 11 May 2011 has approved the proposal to amend the Policy on allowing FDI in LLPs in a calibrated manner beginning with Open Sectors i.e. where monitoring is not required subject to the following conditions:

- (a) LLPs with FDI will be allowed, through the Government approval route, in those sectors or activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions. By FDI-linked performance related conditions, it is meant that in sectors, where certain stipulated conditions are prescribed like Development of Townships, NBFC, Housing, Built-up infrastructure and Construction-development projects, even though 100% FDI is allowed under automatic route, LLP's will not be allowed to bring FDI with the approval of Government of India
- (b) LLPs with FDI will not be allowed to operate in agricultural/plantation activity, print media or real estate business.
- (c) LLPs with FDI will not be eligible to make any downstream investments, which means LLPs having FDI, cannot make further investment in LLPs or companies engaged in any business, even though 100% FDI is allowed under those sectors

Experts' Views

"Initially, the government wants to see how they (LLPs) are bringing in the money (FDI), how they are utilising the funds. As these are not structured like companies, the government is taking a cautious approach," *KPMG Executive Director Krishan Malhotra said.*

Experts have, however, welcomed this cautious approach, while looking forward to a gradual liberalisation vis-a-vis FDI.

"One can understand the cautious approach of the government of not completely allowing FDI in LLPs. However, I hope the government will further open LLPs to foreign investors. Globally, the LLPs are the preferred form of doing business by professionals", Senior Partner of law firm Titus & Co., Mr. Titus said.

There are also further following conditions relating to funding, ownership and management of LLPs.

Funding of LLPs

- **Downstream Investments by Company:** An Indian company, having FDI, will be permitted to make downstream investment in LLPs only if both the company, as well as the LLP are operating in sectors where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions.
- **Investment by Cash Consideration:** Foreign Capital participation in the capital structure of the LLPs will be allowed only by way of cash considerations, received by inward remittance, through normal banking channels, or by debit to NRE/FCNR account of the person concerned, maintained with an authorized dealer/authorized bank. For making non cash/intangible contribution towards the capital of the LLP, permission of Government of India will be required.
- **FII/ Foreign Venture Capital:** Further, Foreign Institutional Investors (FIIs) and Foreign Venture Capital Investors (FVCIs) will not be permitted to invest in LLPs.

- **External Commercial Borrowings (ECBs):** LLPs will also not be permitted to avail External Commercial Borrowings

Ownership and Management of LLPs

- **Determination of Designated Partner:** The LLP Act 2008 provides that atleast one designated partner shall be person resident in India. As per explanation to section 7 of the LLP Act 2008, the term “resident in India” means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.

But for the purpose of determination of the designated partners in respect of LLPs with FDI, the term "resident in India" would have the meaning, as defined for "person resident in India", under Section 2(v) (i) (A) & (B) of the Foreign Exchange Management Act, 1999.

Body corporate as a designated partner: In case the LLP has a body corporate as a designated partner, the body corporate should only be a company registered under the Companies Act and not any other body, such as an LLP or a trust

- **Conversion into LLP:** Conversion of a company with FDI into an LLP will be allowed only if all the stipulations are met and with the prior approval of FIPB or government
- **Compliance of FDI Policy:** Further, the designated partners will be responsible for compliance with the conditions and liable for all penalties imposed on the LLP for their contravention

Presently, FDI is allowed in Indian companies in a firm or a proprietary concern, subject to certain conditions. FDI in a trust is also allowed with prior Government approval, provided it is a Venture Capital Fund (VCF).

The CCEA’s approval will benefit the Indian economy by attracting greater FDI, creating employment and bringing in international best practices and latest technologies in the country.

Conclusion

Since the liberalization of the FDI Policy in 1991, FDI in LLPs is a welcome move of the Government of India and it should benefit the Indian Economy by augmenting FDI, as LLPs are relatively simple and tax efficient entity form as compared to Company. Allowing FDI in LLP would also provide foreign investors an alternate form of business other than company and would entitle them to benefit with inherent flexibility & tax efficient structure of a LLP. It is to be noted that LLPs as opposed to company are not subject to dividend distribution tax (DDT).

The aforesaid move will boost the number of joint ventures in the country and specifically in infrastructure sector, where most of projects till date are executed in form of unincorporated joint ventures.

However, it is to be noted that this is preliminary policy statement and there are lot of issues, which needs to seen into like the reporting system, conditions of transfer of partners interest, valuation of share in contribution of capital, identification of control in case of downstream investment by companies in LLP etc.

One term used in the Press Release which warrants clarification is 'FDI-linked performance related conditions'. It is expected that the policy would also clarify the factors, aspects and need for approval requirement for FDI in LLPs even for activities / sectors falling under the Automatic Route. Therefore it is necessary to wait for the final policy, before making any decision.